

APPLICATION MADE BY THE SOLICITORS REGULATION AUTHORITY BOARD TO THE LEGAL SERVICES BOARD UNDER PART 3 OF SCHEDULE 4 TO THE LEGAL SERVICES ACT 2007 FOR THE APPROVAL OF AMENDMENTS TO THE SRA PARTICIPATING INSURERS AGREEMENT

Section A – details of the proposed alterations

The SRA proposes to amend its Professional Indemnity Insurance (PII) arrangements in order to remove a significant barrier to firms who wish to leave SRA regulation and switch to one of the other regulators approved under Schedule 4 to the Legal Services Act 2007 (“Approved Regulators”).

The proposed change will be effected through the SRA Indemnity Insurance Rules 2013 (Amendment) Rules [2017], attached at Annex 1. These amendment rules will amend the SRA Minimum Terms and Conditions of Professional Indemnity Insurance in Appendix 1 to the SRA Indemnity Insurance Rules 2013.

The amendments will remove the obligation on insurers to provide run-off cover for firms that switch to another approved regulator. Currently, run-off cover applies to claims arising from prior work carried out before a firm switches regulators. The present run-off period is six years.

There is already an overarching Framework Memorandum of Understanding (FMOU) in place that sets out how the Approved Regulators communicate and co-operate to avoid duplication and conflict between differing regulatory arrangements. Building on the FMOU, we will agree a switching protocol between the Approved Regulators. This sets out that the receiving regulator is responsible for the adequacy of indemnity insurance arrangements once a firm has been authorised by them. It also sets out obligations to share information so the receiving regulator can properly assess the risks of the firm requesting to switch to them and whether the level of consumer protection is adequate. The proposed switching protocol is attached at Annex 2.

Section B – nature and effect of the existing regulatory arrangements

The SRA’s current PII regulatory arrangements constitute a significant barrier to firms regulated by the SRA switching to a different regulator.

This is because when a firm moves to a different regulator, a requirement for six years of run-off cover is triggered by the insured firm moving outside SRA regulation. Other regulators have their own indemnity insurance requirements, so firms can find themselves needing to have dual cover in place, which can be a barrier to switching. S.5.4 of the SRA Indemnity Insurance Rules 2013 - Appendix 1 (SRA Minimum Terms and Conditions of Professional Indemnity Insurance) states:

“5.4 Run-off cover

The insurance must provide run-off cover:

- (a) in the event of a *cessation* that occurs during or on expiration of the *policy period*;
- (b) in the event of a *cessation* that occurs during the *extended indemnity period* or the *cessation period*; or
- (c) from the expiration of the *cessation period*;

and for the purposes of this clause 5.4, an *insured firm's practice* shall (without limitation) be regarded as ceasing if (and with effect from the date upon which) the *insured firm* becomes a *non-SRA firm*.”

Section C – nature and effect of the proposed alteration

We propose no longer requiring six years' run-off cover for firms which are moving to a different Approved Regulator. This will remove a barrier to switching and enable firms to make effective business a decision about which regulatory regime is appropriate for the legal services they provide.

This means that the new regulator would be solely responsible for the level of indemnity insurance available for future claims for financial loss including from prior transactions completed or in progress before the switch. In order to allow the new regulator to assess the adequacy of consumer protections going forward we will expect the approved regulators to agree a switching protocol to facilitate the sharing of information when a firm wants to move to another regulator.

The change will not apply to approved regulator that do not sign up to the switching protocol.

The proposed amendments add a new clause 5.8 to the SRA Minimum Terms and Conditions of Professional Indemnity Insurance. Clause 5.8 states that clause 5.4 will not apply where the insured firm becomes regulated by another Approved Regulator that has signed the switching protocol

The full wording of the amendment rule is set out at Annex 1.

Section D – rationale for amendment

The current arrangement poses a significant barrier to firms wishing to leave our regulation. In some cases, the cost of run-off cover under the current requirements may be preventing firms from seeking out the most appropriate regulator for their business. A number of firms wishing to change regulator to the Council of Licensed Conveyancers (CLC) have asked the SRA to consider our position.

Section E – statement in respect of the LSA regulatory objectives

E1 *Protecting and promoting the public interest.* It is in the public interest for legal services providers to be covered by the regulatory regime most appropriate to their business. Currently, the run-off cover requirement is a deterrent to firms moving from SRA regulation to another Approved Regulator. Removing the current restriction will therefore help promote the public interest.

Additionally, an effect of the change may be that any savings are passed on to consumers in a competitive legal services market.

E2 *Supporting the constitutional principle of the rule of law.* The proposal is neutral in respect of this objective.

E3 *Improving access to justice.* The proposal may benefit this objective by enabling legal services providers to choose the most appropriate regulator, removing a barrier to competition while enabling the market to adapt and meet the needs of the public seeking to access justice.

E4 *Protecting and promoting the interests of consumers.* Consumer protections arrangements differ across the approved regulators. If a firm switches regulators, a consumer may face the risk of a different level of protection to that they had when they originally chose the firm. This is why we will only allow run-off cover not to be triggered if the firm is switching to another approved regulator that has signed the switching protocol. This requires regulators to share information so the new regulator can assess the adequacy of the indemnity arrangements before accepting the firm into its regulation.

E5 *Promoting competition in the provision of legal services.* The proposal may benefit this objective in that, by enabling legal services providers to choose the most appropriate regulator, legal services provision will not be artificially restricted by barriers on which an Approved Regulator regulates each legal services provider.

E6 *Encouraging an independent, strong, diverse and effective legal profession.* The proposal is neutral in respect of this objective.

E7 *Increasing public understanding of the citizen's legal rights and duties.* The proposal is neutral in respect of this objective.

E8 *Promoting and maintaining adherence to the professional principles.* The proposal is neutral in respect of this objective.

Section F – statement in respect of the better regulation principles

F1 *Proportionality.* The proposal is proportionate to the risk. Firms switching to another Approved Regulator will be covered by their new professional indemnity insurance including for the period that would have been subject to SRA run-off cover. The new regulator will need to assess the adequacy of their arrangements for the firm switching to them including for historic work.

F2 *Accountability.* The proposal makes clear that the new regulator is responsible for indemnity arrangements once the firm is regulated by them including for historic work. It is not possible for the old regulator to regulate any aspect of the indemnity arrangement once a firm has moved outside its regulatory reach..

F3 *Consistency.* The proposal will apply consistently to all firms wishing to switch regulators. Additionally, the proposal helps create a level playing field between firms seeking to move from SRA regulation to another Approved Regulator and those already regulated by that Approved Regulator.

F4 *Transparency.* The proposals are clear and will be supported by a switching protocol, described further at Section I below.

F5 *Targeted only at cases in which action is needed.* The proposals extend only to those adversely affected by the current restrictions: that is, SRA-regulated firms seeking to switch to a different Approved Regulator.

Section G – statement in relation to desired outcome

The desired outcome of the proposed change is that an unnecessary barrier to firms switching to the most appropriate regulator will be removed.

Section H – consultation and stakeholder engagement

The SRA published a consultation document on 21 April 2016, and the consultation period closed on 14 July 2016. We received 17 responses from a variety of

stakeholders, including the Law Society and other solicitors' representative bodies, the Legal Services Consumer Panel, other Approved Regulators, a participating insurer, the Council of Mortgage Lenders (CML), a number of legal services providers and the International Underwriters Association.

Generally, respondents were supportive of the aim to make it easier to switch regulators. However, a general concern was expressed that appropriate safeguards must be in place to ensure that consumers remain protected. Views on where the responsibility for making sure they were in place were mixed:

- The Legal Services Consumer Panel supported the proposal as they felt the current requirement was unduly restrictive and the unjustifiable cost would be passed back to the consumer.
- Approved regulators were in favour of the removal of the run-off cover obligation when a firm switches regulator, although more information was sought and concerns about consumer protection was also raised
- The Council of Mortgage Lenders was broadly supportive of the proposed change, as were those insurers who responded.
- The Law Society believed that there should be not be any reduction in current client protections and a switching firm's obligations to have run-off cover should remain equivalent to the SRA's SRA Indemnity Insurance Rules 2013 Minimum Terms and Conditions.

Given the concerns, we undertook further consultation with the approved regulators on three options for maintaining appropriate client protection in respect of claims arising from prior work carried out before a firm switches regulators. The outcomes of these discussions are set out in Section I. We are also publishing our response to the consultation, which will include the preferred option, that this should be the sole responsibility of the new regulator.

Section I – statement in relation to impact on other approved regulators

Following consultation with the approved regulators, as described in Section H, we are proposing that:

- Responsibility for consumer protection in respect of future claims arising from past activities is the sole responsibility of the new regulator.
- Any differences in the level and scope of consumer protection, following the switch would then be a matter for the new regulator.
- Additionally the LSB has a responsibility for oversight and approval of all of the approved regulators indemnity arrangements.
- As part of the switching process, the respective regulators and the firm would need to share information, including their supervisory and claims history and the extent of their previous insurance cover.

This approach provides a “clean break” between regulatory regimes and clarity to consumers on which regulator is responsible for consumer protection. The approach is reflected in the proposed switching protocol between the approved regulators. This sets the responsibilities for indemnity insurance arrangements and obligations to share information so these requirements can be properly understood. This will help make sure that the authorisation and closure processes are aligned for regulators and that the information made available to the new regulator is sufficient to for them assess whether adequate consumer protection is in place after the switch.

Section J – implementation timetable

In addition to the LSB's approval, in order to implement the change the SRA will need to agree a switching protocol attached in draft at Annex 2 with the other approved regulators.

We have had a series of discussions with the approved regulators on the draft protocol. We are making progress in establishing what information will need to be shared and how the current switching process and procedures would need to be changed. The rule is drafted in such a way that it does not require one significant change. The non-triggering of run-off will only happen once an approved regulator has signed the protocol. Two approved regulators have said they do not need to sign the protocol because they do not envisage any firms switching to them.

We propose that the change should come into force on 1 October 2017. Our aim is to have the rule change in place by 1 October 2017 or on seventh day following approval by the Legal Services Board (LSB), whichever is the later.

Section K – SRA contact for matters relation to the application

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Section L – Annexes to the application

Annex 1 – Proposed amendments to the SRA Participating Insurers Agreement

Annex 2 – Switching between approved regulators protocol – current draft

Annex 3 – SRA Response to our Consultation on switching regulators

Annex 1 SRA Indemnity Insurance Rules 2013 (Amendment) (No 2) Rules [2017]

Rules made by the Solicitors Regulation Authority Board on [date made by Board] under sections 31, 37, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, and section 83 of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007.

Approved by the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007 on [date of approval by LSB].

Rule 1

Amend the SRA Minimum Terms and Conditions of Professional Indemnity Insurance in Appendix 1 to the SRA Indemnity Insurance Rules 2013 as follows:

- (a) at the beginning of clause 5.4, insert “Subject to clause 5.8,” and replace “The” with “the”;
- (b) in the final paragraph of clause 5.4, after “clause 5.4” insert “and clause 5.8”;
- (c) after clause 5.7 insert:

“5.8 Transfer to another approved regulator

Clause 5.4 above does not apply where the *insured firm* becomes an *authorised non-SRA firm* provided that the *approved regulator* of the *authorised non-SRA firm* is a signatory to the switching between *approved regulators* protocol.”

Rule 2

These rules come into force on 1 October 2017 or on the seventh day following approval by the Legal Services Board, whichever is the later and replace the SRA Indemnity Insurance Rules 2013 (Amendment) Rules 2017 which never came into force.

Annex 2

STILL IN DRAFT

Switching between approved regulators protocol (“switching protocol”)

Introduction

1. The Legal Services Act 2007 (LSA 2007) regulates and authorises the provision of legal services. This protocol sits under the overarching Framework Memorandum of understanding (FMOU) signed by the approved regulators and other professional regulators. The aim of the FMOU is to help the approved regulators to work collaboratively in exercising their public functions and to meet the needs of consumers. The parties are committed to pursuing the aims and purposes of this FMOU in accordance with its terms on a voluntary basis (in so far as so acting would not conflict with any legal obligation). The parties to the FMOU are:
 - a) approved regulators as defined by the LSA 2007; and
 - b) licensing authorities as defined in the LSA 2007.
2. For the purposes of this switching protocol the term 'approved regulator' is used to mean either approved regulator or licensing authority.
3. This switching protocol mirrors the terms of paragraph 3 of the FMOU and does not create any legal or procedural rights, prevent compliance with the law, fetter or restrict discretion of the parties nor create any legitimate expectations on the part of any person or the parties.
4. Consumer protection arrangements including requirements for the level and scope of professional indemnity insurance (“indemnity arrangements”) can be put in place by approved regulators to provide financial protection to clients of firms. These protections are overseen by the Legal Services Board.
5. The Legal Services Board has recently reviewed switching arrangements across the approved regulators. The review acknowledged that switching arrangements between regulators do not present a material risk to consumers. The findings indicated that while the level of switching remained low, the data on this was captured in an inconsistent manner. It also identified a need for greater assurance about the information sharing between regulators during the authorisation processes.
6. The aim of this switching protocol is to:
 - a) confirm the responsibility of a firm's regulation and its indemnity arrangements once a firm switches regulator.
 - b) provide a framework to facilitate the switching of regulators, including the sharing of lawful information in support of the protection of consumers.

- c) support the parties in keeping consumers informed about who regulates which individuals and firms.

Protecting the financial interests of consumers

7. This protocol recognises that:
 - a. absolute protection is not achievable at reasonable cost and this is ultimately reflected in the cost of legal services to the public.
 - b. indemnity arrangements differ across the approved regulators.

Responsibility for indemnity arrangements

8. Consumer protection is the responsibility of the regulator authorising a firm.
9. It is the responsibility of the receiving regulator to assess all relevant risks to consumers should the switch take place and to make such enquiries as it thinks fit to satisfy itself that it can be a suitable regulator of the firm seeking to switch.
10. The receiving regulator becomes 'the regulator' upon its authorisation of the firm and from that date is solely responsible for the indemnity arrangements of the firm.
11. The receiving regulator will decide if it is necessary for the firm to take steps, as the regulator thinks fit, to notify clients of any changes to their protection.

Sharing information

12. Where it is lawful, the parties agree to disclose information to enable the receiving regulator to evaluate the regulatory risk of a firm against the level of consumer protection the receiving regulator will have in place following the proposed switch.
13. Where information is shared it is shared in accordance with paragraphs 10-13 of the FMOU.

Keeping consumers informed

14. Each party agrees to aim to keep relevant consumers fully informed so that they understand:
 - a) who regulates relevant individuals and firms;
 - b) the protections afforded in each case
 - c) where and how redress may be sought.

The date of this protocol is.....

Signatories:

Approved Regulators	Signed on behalf of the Regulator
Solicitors Regulation Authority Name: Position:
Bar Standards Board, part of the Bar Council Name: Position:
Council for Licensed Conveyancers Name: Position:
CILEx Regulation Ltd Name: Position:
The Patent Regulation Board (established by The Chartered Institute of Patent Attorneys) and the Trade Mark Regulation Board (established by The Institute of Trade Mark Attorneys) (together The Intellectual Property Regulation Board) each signing pursuant to Clause 5 of the Delegation Agreement dated [2nd] December 2009 Name: Position:
Master of the Faculties Name Position:

Costs Lawyer Standards Board	 Name: Position:
I Institute of Chartered Accountants of England and Wales	 Name: Position:

Definitions

Approved regulators are designated under Part 1 of Schedule 4 of the LSA 2007 in respect of reserved legal activities as specified in the Schedule. Approved regulators authorise individuals to carry on any reserved legal activity in respect of which it is a relevant¹ approved regulator. Approved regulators also regulate traditional entities² pursuant to the LSA 2007 and other legislation applicable to each regulator. In most cases where the Approved Regulator is also the representative body, regulatory functions are delegated to front line regulators.

Licensing authorities are permitted under the LSA 2007 to license entities known as licensed bodies which can provide reserved legal services alongside non-reserved and non-legal services. An approved regulator may be designated as a licensing authority under Part 1 of Schedule 10 of the LSA 2007 in respect of its approved reserved legal activities.

¹ An approved regulator is a 'relevant approved regulator' in relation to an activity which is a reserved legal activity of which the approved regulator is designated by Part 1, or under Part 2, of Schedule 4 to that reserved legal activity (S20(3)(a) of LSA 2007)

² Firms delivering only legal services

Individuals are regulated personally by their own professional regulator but may be involved in an entity which itself is regulated by a different regulator being either a licensing authority or an approved regulator. In these cases, such an individual may also be regulated by the entity regulator.